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indefinite advance in the prices of securities. But just how long the resultant condition of inflation can be supported and maintained is gravely problematical.

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PRICES, CREDIT, AND THE QUANTITY THEORY AGAIN

The appearance of Professor Joseph French Johnson's *Money and Currency* gives occasion for raising anew certain questions regarding the effect upon prices of quantity of money and credit. Professor Johnson's treatise covers a wide field, including value of money, credit, monometallism, bimetallism, domestic and foreign exchange, fiat money, and the history of money in the United States.

It may be noted in passing that on the whole, the descriptive portions of the book are well done—in some cases exceptionally well done—and though one may differ with the author on questions of theory, in most cases his position is at least clearly expressed. One or two exceptions to this will be pointed out. There seem, however, to be serious defects in the theoretical part of the discussion, and it is to these that attention is here, perhaps somewhat ungraciously, directed.

Concerning the uses of money our author declares:

Exchangeability is the only utility possessed by money, and it is on account of this utility, and this only, that it is wanted. Money performs a specific service for men, like a hoe or a knife, and is wanted for no other purpose. (P. 11.)

Regardless of his position that money was probably used as a medium of exchange *before* it was employed as a standard of prices or value, is it true that money is wanted for example in bank reserves exclusively as a medium of exchange? Is there not rather a portion of money here which is constantly reserved from this use? Does it not serve to insure solvency of the financial institution, and to make its credit instruments acceptable? So also of the reserve held in the United States Treasury. The author would doubtless say that this use grows out of its use as a medium of exchange. Possibly; but even so it does not follow that the two uses resolve themselves into one because the second grows out of the first.

Again, the author intimates that other writers have been led into error by assuming that the value of gold is constant, and that gold is therefore a perfect standard for deferred payment. The reviewer does not know of any economic work where this assumption is made. Business men may unconsciously assume the stability of the value of gold, but economic writers on this question have generally asserted the contrary. In discussing the functions of money, Professor Johnson seems to have been led to extremes by an overzeal for refuting theories of other writers on the subject. But in fact, incredible as it may seem, he has left this question in even greater confusion than he found it.

In his discussion of the value of money, our author has adopted the well-worn demand-and-supply explanation, defining demand as follows:

By the demand for money in a country is meant the general need or desire in that country for utility in a form possessing universal and immediate acceptability. This evidently depends on the volume of business transactions, upon the population of the country, the qualities of goods they produce and exchange, their customs with regard to the use of credit as a medium of exchange, and their habit with regard to the keeping of sums of money on hand. (P. 19.)

This statement is modified as follows:

No matter how strong may be the desire for money, if the desire lead to no exchange, and so does not call for the use of money, it is no part of the economic demand for it. (P. 21.)

Although demand is held to mean desire, desire seems to be measured by the number of money units required to make exchanges, and to depend largely on volume of business. Nothing is said in this connection about demand at a given price-level. One is left here with the impression that increase in volume of business necessitates increase in amount of money; but elsewhere one learns:

The desired amount of money utility will always be in existence, for it is created by the need for it. If the supply of money is \$1,000,000, the need for *value* in a form immediately exchangeable will give to that million dollars a purchasing power sufficient to render it capable of transacting all the business of the community. . . . Thus the supply of money varies in *value* automatically, always tending to equal the demand. (P. 28.) The stock of money in a country under normal conditions always represents and measures the real need or demand for money utility. (P. 24.)

Would our author then measure demand by a *stock of money* or by a *value of money*? He says in one place that a given stock of money, \$1,000,000 for example, may automatically meet any increase in demand for money. In another place he says: "The demand for money is measured by the *amount* needed to make exchanges and to serve as a store of value for use in future exchanges" (p. 22). The whole study of demand and supply is clouded by the confusion indicated in the above quotations. To speak of amount of money needed unless a definite price-level is involved is a hopeless confusion of words, just as it is to speak of an increase in demand for goods without specifying price. Evidently the important quantities for the author's theory are number of money units and volume of goods exchanged. The quantities involved can be algebraically expressed, and there is no reason for confusing the discussion with expressions involving quantities of utility and desire. If it is worth while to hold a quantity theory at all, it is worth while to express it in a quantitative algebraic ratio. For a clear expression of the quantity theory the author would be practically driven to the method which he criticises in J. S. Mill's work (p. 20). An expression of demand for money in terms of the quantity of goods exchanged at a given price-level is the method employed by Mill, although he is not careful to mention the question of price-level. The author practically comes to this expression of the theory in paragraphs 78, 79, 80, 81, and his meaning here becomes clearer.

In these paragraphs, however, and throughout Professor Johnson's discussion, it is assumed that the whole stock of money is constantly employed. Now, a careful observation of the relation of bank reserves to loans and discounts during the past fifteen years will show that this is an error. The period from 1893-97 may be taken for illustration. A comparison of reserves with loans and discounts quoted weekly in the Banker's Gazette of The Commercial and Financial Chronicle, shows that at times a rather large amount of money lies idle in bank reserves. When some articles are cheapened and their quantities are not sufficiently increased to employ the same amount of purchasing power as formerly, it does not follow that this purchasing power will be immediately employed in buying other goods. Again, a very large production of raw materials abroad might cause a smaller amount of purchasing power in terms of money to be applied in the purchase of American produce. Or failure of crops abroad might cause a larger amount of purchasing

power to be applied to American produce and raise prices. Or if demand abroad falls off this may force the sale of goods at such a price as not to employ the greatest possible purchasing power in a given country. While during a period of rise in prices, when every man is attempting to expand his business, the purchasing power of the community may be expanded and bank reserves used to their utmost. Certainly the amount of money in a country is not the only determinant of prices. All this may not be contrary to the author's quantity theory, but he seems to lose sight of such influences in determining prices and price fluctuations. In the past price changes do not seem to have been caused by fluctuations in amount of money to the extent that our author's theory implies. Although the author emphasizes that enlarged bank reserves take immediate effect, he recognizes the influence of varying amounts of credit accompanying a given amount of money in causing price changes. Before examining this phase of the credit question, however, it may be well to consider the author's theory concerning the foundation of credit.

He defines credit as a promise to pay (p. 35), and treats it with reference to its use as a medium of exchange.

The basis of credit is confidence. . . . This confidence is twofold in character. The lender must, in the first place, feel morally certain that the borrower is going to be able to pay his debts; that his affairs are in such shape, or that his business ability is such, that he will be able to pay the debt when due. In the second place, the lender must feel certain that the borrower is a man of integrity who will not seek to avoid payment. (P. 37.)

Throughout the author's discussion increase in amount of credit is assumed to cause price rise by virtue of an increase in confidence. In one small paragraph it is vaguely suggested, but by no means clearly set forth, that this confidence is in the ability of the borrower to sell goods. This idea is more fully expounded in Laughlin's *Principles of Money* (pp. 78, 79). A careful analysis of bankers' loans shows that they lend to borrowers, who are supposed to use the loan in the purchase or creation of a salable product. The usual source of the liquidation of loans is the purchasing power acquired by the sale of the goods purchased by the loan or by the sale of some other goods. When prices are advancing and profits are high, there is no fear that the proceeds of sales will fall below costs, and loans are obtained by men who may not possess originally a very large proportion of the quantity of funds borrowed. The lender is sure

that the proceeds of sales will furnish funds for liquidation of the loan. If the market is contracting and prices are falling, the banker requires that the borrower own a rather large margin of salable product, because of doubt concerning the stability of price. The banker knows that, if prices continue to fall, the proceeds of sales may not liquidate the loan. Hence all owners of funds and goods must accept from bankers a smaller amount of purchasing power, and a contraction of credit results. The author, however, explains this contraction by the decrease in confidence. If so many learned men had not used this word "confidence" as being the basis of credit, the student might be tempted to say that it is a good word to cover up a vast amount of misconception of the real forces at work causing the expansion and contraction of credit.

Our author also attacks the view that goods are the things loaned instead of money. He insists that the bank does loan money and credit on the basis of confidence (p. 38). It is perfectly commonplace that the bank cannot at any moment cash its loans. The borrower gives his promise to pay in order to get goods or services. The sellers of goods and services are perhaps not willing to accept the promise to pay of the borrower, because they may not find it generally acceptable. The bank, however, transforms a credit instrument not generally acceptable into one that is generally acceptable. This has been called guaranteeing or underwriting the credit of the borrower.¹ The borrower expects to get goods through the medium of his promise to pay guaranteed by the bank. It is possible to conceive of a community in which individual promises to pay guaranteed by a bank might form the only medium of exchange. In the modern business world perhaps the larger portion of the exchanges carried on between large dealers are of this character. The bank is the channel of purchasing power, and, when purchasing power resulting from the proceeds of sales goes into the bank at approximately the same rate as the purchasing power guaranteed by the bank goes out to borrowers, the bank is properly performing its function. It must keep a reserve, however, since the outgo may at some times have an accelerated rate as compared with the rate of the inflow of purchasing

¹ In an unpublished manuscript Professor Davenport has shown that the province of the bank is that of an underwriter of credit. The bank is the underwriter of the borrowers' promise to pay. The credit thus becomes current as purchasing power. Just as the underwriting bank may give securities prestige and acceptability, so it may give the promise to pay of an individual general acceptability. Consult also W. G. L. Taylor, *Journal of Political Economy*, June, 1905.

power. The author concludes that "credit is limited, therefore, not by a community's wealth, but by that plus lenders' estimates of its power to produce wealth" (p. 38). It is perfectly clear that the number of units of purchasing power is not at any time limited by the wealth of the community. It is also clear that purchasing power is only a medium through which the borrowers get goods. Practically the borrower gets goods from the seller through the medium of his promise to pay. There may be an increase of wealth in terms of price through the multiplication of promises to pay, but this multiplication cannot cause an increase in the amount of loanable goods. It seems superficial to consider money or credit as the end sought by the borrower.

A fuller discussion of the theory of credit is found in the consideration of the loan fund. The following quotations show the author's position :

The lending power of banks varies with the savings of the people. . . . The loan funds in the possession of banks are derived from and are representative of the loanable capital in the country. When the amount of loanable capital increases, the amount of loanable funds increases in a corresponding degree. . . . The loanable capital and the loanable fund of a country are practically the same thing. . . . It should be noted that the capital fund of a country arises not only from the sale of capital goods, but also from the sale of goods that are ready for consumption, which are called "consumer's goods." (Pp. 139, 140, 142.)

Now let us take in this connection a quotation from the doctrine of credit expounded in an earlier portion of the book: "Credit is limited, therefore, not by a community's wealth, but by that plus lenders' estimates of its power to produce wealth" (p. 39). The contradiction in the two doctrines is so plain as to require no comment. Without discussing in detail any doctrine of loan fund, let us assume that our author is right in saying that the loan credits in the hands of banks are the loan fund. In which of these two doctrines above stated is the author right? Or is he wrong in both? It is rather strange that two contradictory statements such as these should both be in error, but such seems the case. The loan credit in the bank may have its origin in the supposed power of the dealer to buy goods and sell them at a price which will cover all costs. If prices are not rising, the bank may require a rather large amount of funds or salable commodities in excess of the amount used in the purchase of goods, as a margin to secure the loan. Although some margin

of goods or funds may be required by the banker, the loan seems to have its origin in the supposed power and willingness of consumers to take the goods purchased at a price such that the proceeds of the sale will cover costs and liquidate the credit. The number of units of purchasing power in the loan fund does not depend altogether on the quantity of savings. It seems to have its origin neither altogether in the savings of the borrower nor in the savings of others. The wages of the consumer may be spent in the purchase of the goods, and this may liquidate the credit.

It is possible now to discuss the doctrine that the loanable capital and the loanable fund are the same thing and increase together. Let us take the illustration used by the author (p. 140). He says:

If for any reason, such as a rise in the rate of interest caused by a war, a people become more parsimonious and the capital fund of a country suddenly increases, at once there is a strong demand for capital goods and their prices rise.

Is he right here in his assumption of the cause of the increase in the loan fund? Does it not take place in an altogether different way? Suppose the war occurs in Europe. The large dealers and manufacturers will foresee the price rise, and will at once seek to enlarge their business by increasing their loans. The banker also sees that these business men will be able to sell an increased amount of goods in terms of price, and will therefore be able to liquidate larger loans. The amount of loans may evidently increase without any previous increase in the savings of capital goods or any other kind of goods. Bank credit is used to discount the proceeds of future sales.

People are not commonly held to become more parsimonious on account of a price rise due to prospect of war. The price rise in this connection is not commonly caused by an increase in savings, but by a sudden multiplication of purchasing power in terms of money units.

After what has been said above, it seems needless to discuss at length the statement that the loan fund in terms of the number of units of credit-purchasing power always decreases with the decrease in the amount of the fund of commodities, or what the author calls consumer's goods and capital goods. If the market for American produce is narrowed on account of an abundant harvest and an increased manufacture abroad, prices will probably fall, because the foreign purchasing power ceases to be applied to the purchase of the American goods. Because of falling prices bankers will contract

their loans in anticipation of the smaller amount of purchasing power in the hands of consumers who must take the product, if it is sold. There is as large a mass of goods as formerly, but a contraction of the loan fund because of a narrowing of the market for the produce. The goods must be sold for less in terms of price than was formerly anticipated. Creditors suffer, the banks contract their loans, and the result is an overproduction. This means that there must be a readjustment of the price-level before the goods can be sold. In this readjustment creditors will probably suffer.

The author's theories of fiat money and of bimetallism are in accord with the quantity theory, which he seems to hold. His inferences may not be—in the present writer's opinion are not—correct in every case, and his logic is at times faulty; but no space can here be taken for a full discussion of these points. The author is, perhaps, rather too dogmatic in all of his theorizing. While this attitude does not greatly mar the descriptive portions of his work, it produces a rather unpleasant effect in the theoretical discussion. The book will undoubtedly find favor as a text, chiefly on account of its clear presentation of a wide range of facts.

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THE BREAKDOWN OF STATE RAILWAY BUILDING IN FRANCE¹

In 1878 the French government broke in part with its past policy of confining itself to subsidizing private enterprise in the building of railways, and itself undertook to build as well as to operate railways. At this time the bulk of the railways belonged to the so-called six companies. Each one of those companies had a practical monopoly of the territory which it occupied. The manner in which the territory of France was divided between the six companies is indicated by the names of the companies: the Mediterranean, the Orleans, the Western, the Eastern, the Southern, and the Northern.

In addition to the foregoing companies, there were numerous small

¹ The statistical data occurring in this article, can be found in R. v. Kaufmann, *Die Eisenbahnpolitik Frankreichs*. To guard against such charges as were brought against me by a writer in this *Journal* in March, 1906, I beg leave to state that this article was written without any reliance whatever on Mr. v. Kaufmann's book, either for statements of fact or for expressions of opinion.